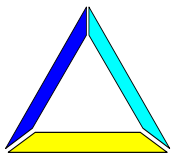
Institute for Economic Research and Policy Consulting in Ukraine
German Advisory Group on Economic Reform

Reytarska 8/5-A, 01034 Kyiv, Tel. (+38044) 278-6342, 278-6360, Fax 278-6336
E-mail: institute@ier.kiev.ua, http://www.ier.kiev.ua



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The Evolution of the EU Common Agricultural Policy: Implications for Ukraine

1 Introduction

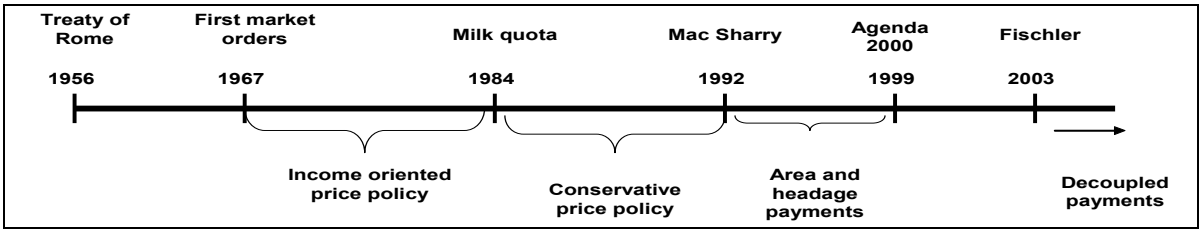
Recently Ukraine has activated its efforts to improve political and economic cooperation with the European Union (EU), seriously aiming at joining the EU. The preparations for accession and membership will have important implications for agriculture and agricultural policy in Ukraine. Already today many agricultural policy decisions in Ukraine have been justified by their use in the EU, for example the sugar quota and grain intervention. Many of these measures, however, are used in Ukraine despite the fact that they proved to be highly ineffective and extremely expensive in the EU. Far more dangerous is that agricultural policy makers in Ukraine fail to recognize the route in which the CAP is evolving, striving for being competitive worldwide without export subsidies, reducing trade distortive measures of support and putting more emphasis on rural development, environment protection and food safety. Although it is difficult to predict the future, it is likely that by the time Ukraine succeeds in joining the EU, the CAP will be characterized by much lower subsidies, mainly belonging to the WTO 'green' box, no export refunds, stricter cross-compliance, as well as larger financing of rural development, environmental, animal welfare and food safety measures.

Agricultural policy in Ukraine is only beginning to take on clear contours. Ukraine can relatively easy adapt the policies needed to stimulate agricultural development and prepare the agricultural sector to the EU membership. It is important, however, not to repeat the mistakes of the 'old' CAP, and rather to look at the new evolving CAP. The old CAP is commonly agreed to be highly distortive and inefficient because it discouraged competition, undermined EU fiscal sustainability, raised serious trade frictions and damaged the environment. Ukraine does not have the resources and time to repeat these mistakes, at least because it will be much more difficult to change its agricultural policy once it and those who benefit from it become firmly entrenched.

At the same time Ukraine has a unique chance to realize the new route of

the CAP and agricultural policies world-wide to develop efficient and adequate agricultural policy by providing core 'public goods' and establishing supporting legal, administrative and regulatory systems in order to stimulate private investments into agriculture. In this paper we provide a review and economic analysis of the CAP, its birth, major reforms, unresolved agenda, faced challenges and evolving trends (Figure 1). This information will allow the better understanding of the recent changes of CAP, their driving forces and implications for Ukraine's agriculture.

Figure 1: Time line of CAP development



Source: Own presentation.

The paper is structured as follows. Chapter 2 presents the review of objectives and principles of the CAP, as well as the analysis of CAP problems during the first decades. Chapters 3 and 4 propose the review of the Mac Sharry and Agenda 2000 reforms. In Chapter 5 the driving forces and the main elements of the Fischler reform 2003 are presented. Chapter 6 considers the unresolved agenda of the CAP and its likely development. Finally, Chapter 7 suggests the set of implications for agricultural policy making in Ukraine.

2 The birth and first decades of the Common Agricultural Policy

The CAP has its roots in 1950s Western Europe, whose societies had been damaged by years of war, and where agriculture had been crippled and food supplies could not be guaranteed. The objectives and general principles of the CAP were formulated in the Treaty of Rome in 1956. In article 39(1) the European Community the **objectives** are stated as:

- to increase agricultural productivity by stimulating technical progress and ensuring the rational development of agricultural production and the optimum utilization of the factors of production, in particular labor;
- thus to ensure a fair standards of living for the farming population, in particular by increasing the earnings of the persons engaged in agriculture;
- to stabilize markets;
- to assure the availability of food suppliers;

- to ensure that supply reach consumers at reasonable prices.

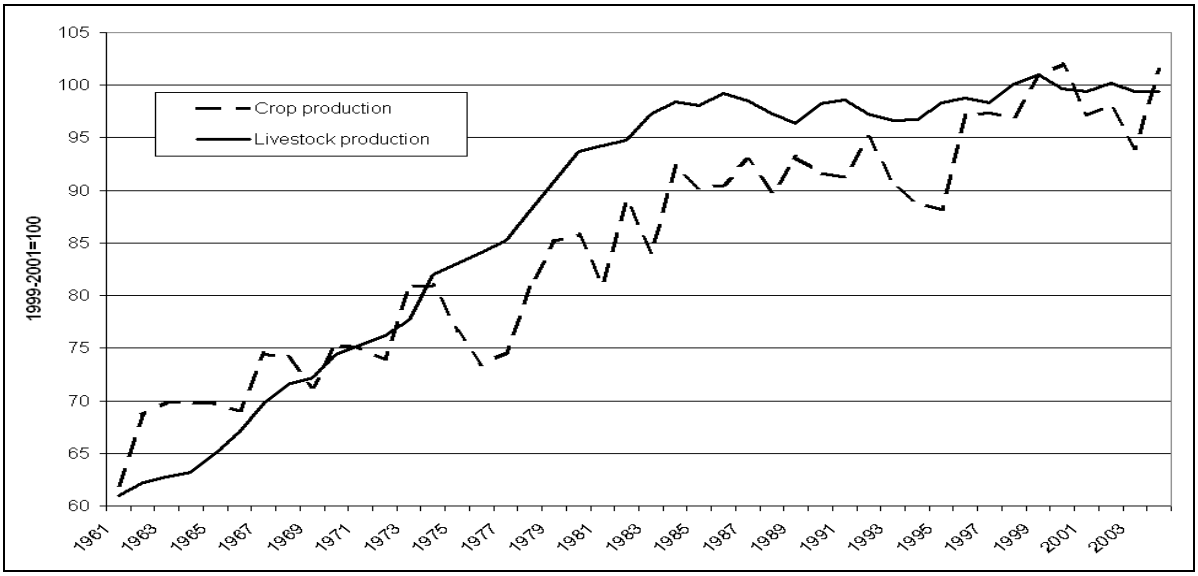
It is clear that these policy objectives are formulated rather flexibly and some of them are defined with rather vague qualifications such as 'fair' and 'reasonable'. Only for the first objective are the instruments (that is, the means for achieving the objective) given. Moreover, the first objective is related to the second, because an increase in productivity is assumed to contribute to fair standards of living. From the very beginning of the CAP, **market and price policies** received the most attention.

In order to achieve above objectives, the EU developed **three principles** of the CAP:

- free movement of goods within the EU and common prices for the same good;
- community preference, which implies that the policy mechanism leads to a preference for products produced domestically above imported ones;
- common financial responsibility for market and price policies of the European Community.

These basic principles had many implications for the way policies were set. Market and price policies fatally became the 'hard core' of the EU agricultural policy, partly because of a failure to appreciate the potential growth in production (see Figure 2), partly because of a fresh memory of the post-war food shortages and partly because of the overriding necessity to achieve a political agreement in agriculture to cement the establishment of the European Economic Community (HUBBARD and RITSON, 1997). The cereals support prices were set 50% above the world marker level. As a consequence, because most other agricultural products are related to cereals, either as competitive arable crops or as users of cereal-based feeding-stuffs, most other agricultural product prices had similarly to be set at relatively high levels. During the 1970s and 1980s the desire to guarantee self-sufficiency in basic foodstuffs was largely realized, but the production-oriented subsidy policy became a victim of its own success (EUROPEAN COMMISSION, 2004). Unfortunate side effects began to appear, such as (a) inefficient high-cost production; (b) impeded structural adjustment; (c) disadvantaged low-income consumers; (d) benefited large farmers greatly and small farmers very little (because the benefit was distributed pro hectare and amount produced); and (e) trade conflicts with both rich and poor countries alike.

Figure 2: Growth of crop and livestock production in the EU-15, 1999-2001=100, 1961-2003

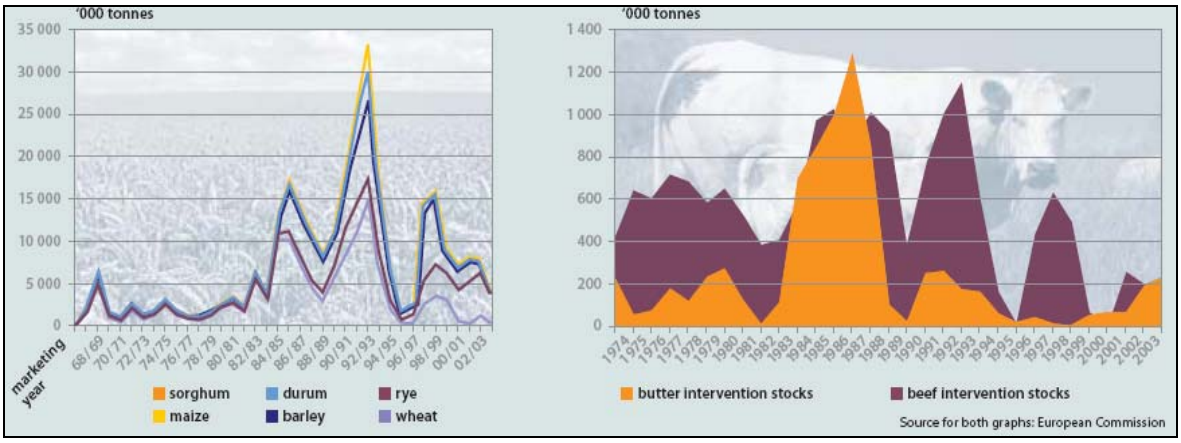


Source: FAO Online Database (www.fao.org).

By the 1980s the EU had to contend with almost permanent surpluses of the major farm commodities, some of which were exported with the help of export subsidies, others of which had to be stored or disposed of within the EU (see Figure 3). During the 1980s, the European Commission tried to control the growth of agricultural surpluses and thus, agricultural budget expenditures. In 1984 the milk quota was introduced to control the production of milk and dairy products. The Commission also introduced the package of 'budgetary stabilizers' to keep the budget expenditures under control. If actual agricultural production exceeded the 'maximum guaranteed quantities', support prices in the following year were to be automatically reduced in proportion to the overshoot. In addition to the stabilizers, the EU implemented a series of structural measures, including voluntary set-aside, intensification and diversification schemes designed to facilitate the adjustment of supply to demand whilst compensating farmers for the loss of income, and raising the profile of environmental protection (FEARNE, 1997).

But since the stabilizers did not attack the underlying problems of high support payments with permanent incentive to greater production, they were doomed to failure. This was recognized by the Commission itself and it called for fundamental review of the CAP mechanisms "so as to adapt them to a situation different from that of the sixties" (FEARNE, 1997, p. 51).

Figure 3: Development of public storage of cereals, butter and beef (intervention stocks), in 1000 tons



Source: EUROPEAN COMMISSION (2004).

The need to reform the CAP was dictated by several key reasons. As outlined above, the high support prices had greatly encouraged agricultural production. Cereals, dairy and meat products produced at prices that were far above world market levels were constantly in surplus. This led to the growth of budget costs and even caused several budget crises. In 1992, the agricultural budget equalled to ECU35 bill, or 0.61% of total GDP of the EU-12. At the same time, the Producer Support Estimate (PSE) amounted to ECU66 bill,[1] reflecting, in addition to budget transfers, huge transfers of consumers to farmers *via* high domestic food prices. This pressure on taxpayers and consumers could not last forever, especially while the society began seriously considering the justifications for agricultural support.

The CAP created many problems with competitors on the world agricultural markets. Due to the extensive subsidization of its exports, the EU provoked complaints of unfair competition from the USA and the Cairns Group[2]. Those countries were anxious to see the end to the EU export subsidies, which greatly depressed the world prices. These frictions had also some repercussions in other economic sectors, and weakened the EU ability to gain better market access for its industrial products in the ongoing Uruguay Round of WTO negotiations.

3 Mac Sharry Reform 1992

[1] PSE is an indicator of the annual monetary value of transfers from consumers and taxpayers to support farmers arising from policy measures that support agriculture regardless of their nature, objectives or impacts on farm production and income.

[2] The Cairns Group consists of Australia, Argentina, Brazil, Canada, Chile, Colombia, Fiji, Indonesia, Malaysia, New Zealand, Paraguay, the Philippines, South Africa, Thailand, and Uruguay.

In 1992, EU Agricultural Commissioner Ray Mac Sharry initiated the first serious reform of the CAP. This reform consisted of four main elements: cuts in support prices, introduction of direct (compensation) payments, stricter control over production, and greater environmental protection.

During 1993-1996, **cereal prices** were reduced by 30%. This price cut significantly reduced feed costs and consumer food prices, and allowed lowering the beef prices by 15% and butter prices by 5%. To reduce the surpluses even more, the EU farmers had to **set aside** 15% of their agricultural land (except small farms which produce less than 92 tons of cereals). As compensation for the price reduction and land set-aside, farmers received the **direct payments** coupled to the production of specific products. These payments were based on historical yields and set prices. In England, for example, the average farmer received ECU148 per ha of arable land in 1993, while the average Welsh farmer received only ECU116 per ha due to lower cereal yields than in England (5.49 tons *versus* 4.65 tons per ha). In addition direct payments were introduced for cattle growers.

The Mac Sharry reform increased attention to the **rural development and environmental standards**. The reform had a dual purpose of limiting agricultural production and recognizing the farmers as guardians of natural resources. The farmers were set stricter environmental standards, but also granted financial support if they (a) substantially reduced the use of fertilizers and agricultural chemicals, or introduced and continue with organic farming; (b) changed to more extensive crop or livestock production; (c) assisted with the maintenance of the countryside; (d) introduced long-term set-aside for environmental reasons; or (e) made land available for public access or recreation.

The Mac Sharry reforms did not reduce the total costs of the CAP. On the contrary, the CAP budget costs even increased due to the introduction of direct payments. But the Mac Sharry reform made farm support more transparent, less distortive domestically and internationally and less dependable on quantities produced. This is important because different types of agricultural support are associated with different degrees of efficiency. Table 1 demonstrates the transfer efficiency of four policy instruments used in the EU. These instruments are used to attain the same goal – an equalization of farm and non-farm incomes. From Table 1, we can see that in all cases the major beneficiaries of farm support are land owners. If the farmer owns his land, then every monetary unit of the support *via* market price support brings him roughly 26% more income in terms of bigger land rents. In the case of area payments, it equals 91.3%. But if the farmer leases the land, he receives only 12.6% in the case of market price support, 14% in the case of deficiency payments and 46.3% in the case of area payments (VON CRAMON-TAUBADEL and ZORYA, 2004). Since the Mac Sharry reform shifted the CAP expenditures from market

price support to coupled area payments (which are less transfer efficient than decoupled payments introduced in 2003, see below), the CAP expenditures became much more efficient in attaining the CAP objectives.

Table 1: Who benefits from various farm support policy measures

Policy measures → / Beneficiaries ↓	Market price support	Deficiency payments	Area payments	Input subsidy
Farm household labour	10.4	11.5	0.7	7.8
Farm household land	12.6	14.0	46.3	9.4
Non-farming landowners	13.2	14.0	45.0	9.4
Input suppliers	35.7	39.6	2.5	24.8
Deadweight losses (waste)	28.2	20.9	5.4	48.6
Total	100.0	100.0	100.0	100.0

Source: OECD (2002).

The Mac Sharry reform helped the EU to meet its commitments to the WTO Uruguay Round Agreement on Agriculture on market access, domestic support and export subsidies. The export subsidies fell from €10 bill in 1988-1993 to €3.7 bill in 2000s (see Figure 4). The introduction of coupled direct payments allowed the EU farmers to comply with the WTO domestic support requirements, shifting its main support measures from 'amber' box to 'blue' box. Since 'blue' box measures were not subject to reduction commitments, the EU gained additional time to gradually adopt its agriculture to world competition.

4 Agenda 2000

In the late 1990s the approaching EU East enlargement and expected stricter rules of the upcoming WTO Doha Round stimulated the next CAP reform, called the **Agenda 2000**. The EU Eastern Enlargement was expected to add ten new countries with much less developed agricultural sectors compared to those in the EU-15. Due to initial low yields and productivities in these countries, the agricultural production was expected to grow relatively quickly, further reducing the fiscal sustainability of the CAP. Another reason for continued reform was the concern that the existing CAP would fall foul of WTO guidelines after 2000, coupled with the expectation that the next round of trade negotiations would begin in 1999. And finally, there was a pressure from the new priorities of CAP to focus on food safety and quality standards to achieve more environmentally friendly agriculture with higher welfare standards. These pressures added up to a strong case for continued reform in the tradition of the Mac Sharry reforms.

In 1999 in Berlin, the European Council adopted a reform package called Agenda 2000. The Agenda 2000 included four major elements: further decrease of support prices of cereals, beef and veal, and dairy products;

stabilization of agricultural budget 2000-2006; preservation of milk quota until 2008; and increased financing of rural development and non-agricultural activities.

The Agenda 2000 prescribed further reductions in **market support prices** of cereals by 15% in two equal steps. As a compensation, the direct (compensatory) payments for cereals increased also in two steps: from €54 per ton to €58 per ton 2000 and further to €63 per ton, multiplied by the historic reference yield of each region. Compulsory land set-aside was fixed at 10% for 2000-2006. The effective market support level for beef and veal was reduced by 20% in three steps.

The **CAP budget** was set to average €42.3 bill per year, including €4.3 bill for rural development, from 2000 to 2006. In formulating agriculture policy in the Agenda 2000, more emphasis was given to **environmental issues and multifunctional role** of the European farming. The Agenda 2000 introduced a new regulation establishing that any kind of direct income support payments should follow certain rules: (a) environmental protection/cross-compliance principles obliged farmers to apply appropriate environmental measures, if they wanted to get compensatory payments in full; (b) modulation principle allowed member states to reallocate direct payments per farm in a way that was related to employment on the farm; (c) savings from cross-compliance and modulation can be used not only for agri-environment, but also into other rural development measures. Moreover, the integrated rural development policy was adopted, based on subsidiarity principle (decentralized policy).

5 Fischler Reform 2003

In retrospect, the Agenda 2000 reforms were not sufficient to meet the challenges facing EU agriculture. Since support prices for most products, except cereals, remained high relative to world market prices, EU farmers remained uncompetitive without export refunds. This increased the risk of future fiscal imbalances and locked funds out of more desirable rural development.

Moreover, the Agenda 2000 did not solve the main EU problems in the face of the WTO Doha Round, taking into account the strong intention of many WTO members to further reduce domestic support and import tariffs, abolish export subsidies and eliminate 'blue' box.

The Agenda 2000 included provisions for a Mid-Term Review in 2003. This provision was explicitly incorporated into the final text of the Agenda 2000, because at that time the European Commission already anticipated that further adjustments would be needed to ensure the agricultural sustainability in the EU and achieve the CAP goals in the globally integrated world. The EU was highly interested in reaching the new WTO agreement in the Doha Development Round. But to encourage other WTO

members to reach an agreement, the EU had to offer substantial reforms of the CAP in line with the WTO principles and strong wishes of the developing countries. Since the developing countries have become much more organized in protecting their trade interests in the WTO, they are increasingly calling on the EU and other OECD countries to abolish their generous farm support which continue deteriorate world market prices and limit the access of their farmers to the 'Northern' markets. Only serious changes in the CAP could allow the EU to pursue their interests in the WTO and use this momentum for the domestic support of reforms.

The rise of environmental concerns in the EU, together with increasing concern over food safety and the conditions under which livestock is reared in the aftermath of the scandals with dioxin-contaminated feed, BSE and foot-and-mouth disease, also increased the pressure for CAP reform to incorporate more directly the needs of the environment and food safety in farming decisions.

Hence, EU Agriculture Commissioner Franz Fischler proposed a set of reform measures in mid-2003. After lengthy negotiations, they were formally approved in September 2003. The key elements of the reform are decoupling of direct payments from production, modulation, cross-compliance, fiscal plan 2007-2013, fiscal discipline, and reduction in price support.

The centerpiece of the agreement is the requirement that the bulk of direct agricultural subsidies introduced by the Mac Sharry and Agenda 2000 reforms be '**decoupled'** from production. In the past the farmers were eligible for direct payments only if they produced specified agricultural products. Beginning January 1, 2005, farmers receive these payments independent of their production. This decoupling allows the reduction of subsidy-induced overproduction and the restoration of market signals in so far as farmers will look at relative prices not relative subsidies in making their crops and livestock production decisions. Each farmer receives a single farm payment (SFP), related to the amount of land but not the form of agricultural activity or the amount of production. The SFP is based on historical claims for direct payments in the base period 2000-2002. The member states may opt to delay implementation of the SFP by up to two years (AGRA EUROPE, 2003). Some details on the implementation of the SFP are included in Appendix 1.

Full granting of the SFP and other direct payments will be linked to the respect of a certain number of statutory environmental, food safety, animal and plant health as well as animal welfare standards. In the case of non-respect of rather strict **cross-compliance** requirements, direct payments will be reduced while maintaining proportionality with respect to the risk or damage concerned.

Greater attention to rural development and environmental policies, already

raised in the Mac Sharry and Agenda 2000 reforms, resulted in the so-called **modulation** of direct aid payments. All direct aid payments (coupled or decoupled) are to be reduced by 3% in 2005, 4% in 2006, 5% in 2007 (and every year thereafter until 2013). In each case, 1% of the modulated money is retained by the member state. The remainder is redistributed across the EU according to the criteria proposed by Commission. However, each member state is ensured in retaining at least 80% of its own modulated funds. These funds are to be spent on rural development programs, a list of which is presented in the following box.

Rural development programs in the EU:

Assistance is provided to farmers, and others in rural areas, for such actions as:

- Training in new farming techniques and rural crafts
- Assisting young farmers to set up in farms
- Assisting older farmers to retire
- Using advisory services
- Farm/forestry investments
- Modernizing farm buildings and machines
- Assisting farmers to meet demanding EU standards, e.g. environmental, animal welfare, and public health
- Helping establish food processing facilities on the farm so that farmers can earn more income from farm products by adding value to them
- Assistance in marketing agricultural products
- Improving product quality and marketing of quality products
- Support for farming in mountain areas and other areas with handicaps
- Restoring damaged agricultural and forestry production potential
- Making additional improvements to animal welfare
- Renovating villages and rural facilities
- Encouragement of tourism
- Improving access to basic services for the rural population
- Agri-environmental measures to improve the environment
- Afforestation
- Measures to improve forestry management

Source: European Commission (2004).

Following the Brussels summit of October 2002, the **CAP budget** for market support and direct payments (referred to as the traditional "Pillar 1") was fixed for 2004-2006, and limited to a 1% increase over 2007-2013. Under this scheme the CAP budget for Pillar 1 begins at €43.7 bill in 2006 and ends with €42.3 bill by 2013 (at 2004 prices). The new "Pillar 2" (rural development and environmental policies) fund is expected to rise by €1.2 bill per year to reach €15.5 bill by 2013 (see Table 2).

The increased importance of rural development in the reform is underlined by the open-ended budget for the Pillar 2 program in contrast to the strict **budgetary limits** placed on market support and SFP payments. The reform package has clauses to enable the European Commission to make extra cuts to direct aid if the Union looks to be in danger of exceeding its agricultural budget limits. In any year (from 2007) when direct support

appears on course to get within €300 mill of the fixed ceiling, the Commission may propose reduction in direct subsidies.

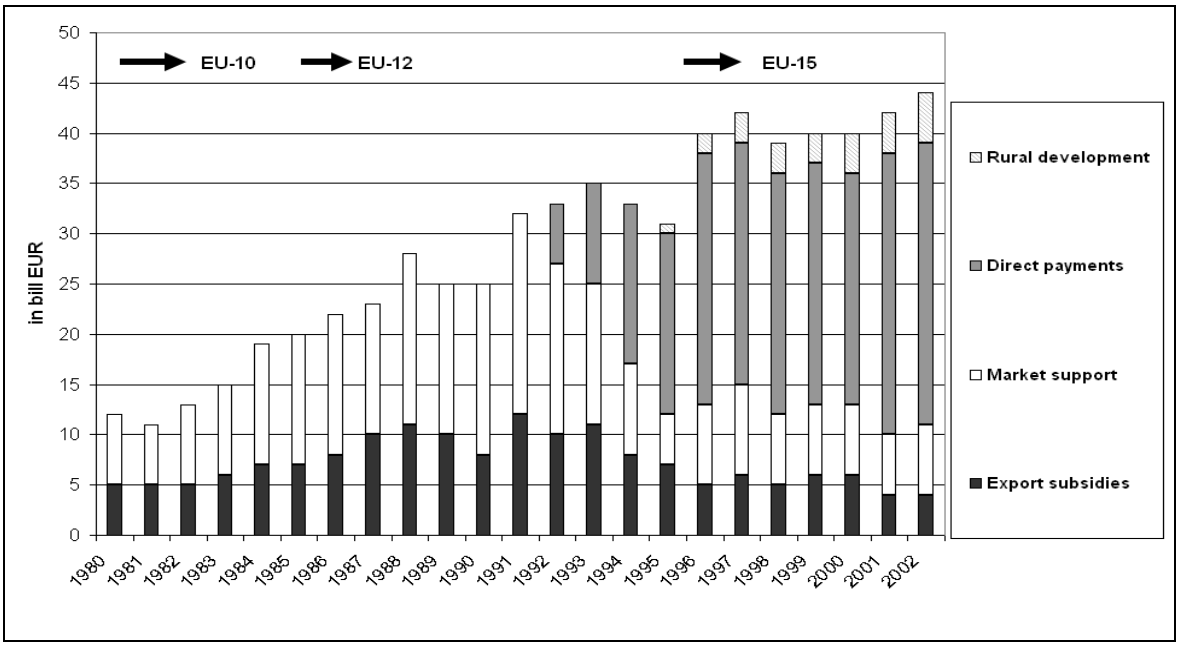
As a further result of the Fischler reforms the cereals **intervention price** will not be reduced (which stays at €101 per ton). However, intervention buying of rye has been abolished. The intervention price for skimmed-milk powder is to be cut by 15% over three years (3x5%, over the period 2004-2006) and intervention prices are to be reduced for butter by 25% over 4 years at the rate of 7% a year in 2004-06 and 4% in 2007 (AGRA EUROPE, 2003).

The Fischler reform has succeeded in decoupling the largest share of the direct payments from production. It offers a policy which will stabilize the incomes of the farmers and enable them to produce what consumers want. The decoupled SPF has distanced the CAP from earlier inefficient policy that sent the messages to farmers to 'produce low quality goods for government stocks'. Those farmers who will continue to produce un-salable commodities for intervention buying will be punished by the market.

Moreover, modulation will enable more expenditure to support new objectives such as maintaining the rural development and addressing the welfare gaps between rural and urban areas. "The provision of food and agricultural products is increasing coming to be seen as a private sector issue which market forces, more than at any previous point in history, are quite capable of addressing" (AGRA EUROPE, 2005).

The Fischler reform will also lead to the reduction of CAP budget costs. Currently the CAP costs about €50 bill per year. This represents only 0.43% of EU GDP compared to 0.54% in the early 1990s. Moreover, by 2013 this share is expected to fall to 0.33% (EUROPEAN COMMISSION, 2004). The CAP operates within a set of strict parameters, and in addition to a declining share of the CAP budget in total GDP and public expenditures, we observe a significant shift in the manner of support, e.g., from production-induced subsidies to decoupled support and rural development (Figure 3).

Figure 4: The evolution of CAP expenditures



Source: EUROPEAN COMMISSION (2004).

Finally, the Fischler reform also sends a strong message to the world and the WTO. 90% of the 'blue' box measures previously coupled to production have been shifted to the 'green' box. Direct payments to tobacco, cotton, olive oils and hops growers are also being shifted from the 'amber' to either 'blue' or 'green' boxes (SWINBANK, 2005). As a result of the reforms, lower dairy prices will reduce the costs of export subsidies and thus, the EU has gained more bargaining power in ongoing WTO negotiations and has even proposed to completely eliminate export subsidies and greatly reduce the 'amber box' measures, i.e. the core of the CAP in the past.

6 Unresolved agenda of the CAP

Despite all changes and achievements of the CAP reforms, the reform agenda in the EU is a long away from being complete. First, developments in the CAP have occurred not only because of changes in farming, but also in response to the demands of society as a whole. Europe's consumers want food that is safe and wholesome. The public concern over food safety and animal welfare has significantly grown after a series of food and animal disease crises, such as BSE and dioxin-contaminated feed. Food safety starts on the farm since the EU rules apply from 'farm to fork', whether the food is produced in the EU or is imported from elsewhere in the world. Hence, in the future it is highly likely that the EU farmers will face **stricter cross-compliance requirements**, whilst receiving **less direct payments and other production support**. The measures from 1st Pillar of the CAP are the subject to financial discipline, and the European Commission has the power to impose the reduction in SPF in the case of budget overruns. There are some estimates that the Commission

will have to initiate such cuts already in the nearest future since it underestimated the production response of the EU new member states to the application of the CAP, the addition of Bulgaria and Romania to the agricultural common market from 2007, and the indeterminate nature of the impact of the 2003 reforms on EU-15 on production (AGRA EUROPE, 2005a). Moreover, given the political commitment to the 'greening' of the CAP and the need to sustain and improve development policies, it is probable that direct subsidies will be the main target for economies.

Second, **the largest net payers in the EU insist on reducing their contributions to the common budget from 1.24% to 1% of the GDP**. If these countries succeed, this reduction will lower the EU budget by about €32 bill per annum. Since the Fischler reform fixed agricultural expenditures in the Financial Plan 2007-2013 (article 2a in Table 2), the Commission will have to cut elsewhere except agriculture, mainly the structural funds. This puts the size of the agriculture and rural development budget very much in the political spotlight, and a recent report by the United Kingdom's House of Lords (from March 11, 2005) has already questioned the whole basis of CAP financing. As the Lords report pointed out "We believe that the current and proposed allocation of resources to agricultural policies is disproportionate. We also consider the agreement endorsed by the European Council in October 2002 to fix agricultural support payments from 2007 to 2013 to be highly regrettable. We recommend that the Council should never again seek to pre-empt negotiations on the Financial Perspective in this way" (AGRA EUROPE, 2005b, p. A/1).

Table 2: The EU's budget for 2007-2013 in mill € at 2004 prices

	2006	2007	2008	2009	2010	2011	2012	2013
1. Structural funds	47.582	59.675	62.795	65.800	68.235	70.660	73.715	76.785
2a. Agriculture: market related expenditures and direct payments (Pillar 1)	43.735	43.500	43.673	43.354	43.034	42.714	42.506	42.293
2b. Rural development (Pillar 2)	12.280	13.680	14.227	14.761	14.856	15.136	15.319	15.512
3. Citizens, freedom, security and justice	1.381	1.630	2.015	2.330	2.654	2.970	3.295	3.620
4. The EU as a global partner	11.232	11.400	12.175	12.945	13.720	14.495	15.115	15.740
5. Administration	3.436	3.675	3.815	3.950	4.090	4.225	4.365	4.500
Total commitments	120.688	133.560	138.700	143.140	146.670	150.200	154.315	158.450

Note: Agricultural and rural development budget accounts for 37% of the EU total expenditures in 2013. But this does not mean that the agriculture takes so huge share in budget expenditures, because there are only five EU activities outlined in this table which are financed from the common budget. All other expenditures such as education, health care, infrastructure, public administration and other expenses are financed from the national budgets of the EU member states.

Source: MUNCH (2005).

Third, the EU will be forced to reform its **sugar policy** in the near future. The sugar policy is under great pressure due to recent WTO panel decision on illegal use of export subsidies and cross-subsidization of C-sugar, and duty-free imports of sugar from the least-developing countries under the "Everything but Arms" agreement. Far reaching and controversial reforms that will bring sugar policy into line with the rest of the post-Fischler CAP has already been proposed and will presumably be adopted before the end of 2005.

And finally, despite lower institutional price levels, market interventions and export subsidies are still and will be needed to maintain prices of cereals, dairy products, beef and sugar. But the eventual agreement in the

WTO Doha Round negotiations will force the EU to cut back on, and eventually eliminate, expenditure on export subsidies. Although the WTO negotiations are unlikely to be completed before the end of 2006, and phased implementation of an export subsidy elimination programme is unlikely to begin before 2007, in the long run the EU will not be able to save the CAP from further reductions in remaining support prices and their harmonization to the world market prices.

7 Implications for agricultural policy in Ukraine

With the Mac Sharry reform in 1992 the CAP began its long march away from support for over-production towards a market-oriented, environmentally friendly policy geared to efficient and sustainable farming. The radical overhaul of the CAP in 2003 (Fischler reform) was just the next logical step towards a policy that supports not just farming, but the long-term livelihood of the rural areas as a whole. Farm support has become increasingly dependent on meeting quality, environmental and food safety guarantees. The EU has become more open to international trade, and in order to preserve its positions in the global marketplace, the reforms of sugar and milk quotas, as well as the remaining market support will follow to ensure the growth of agricultural exports without export subsidies.

It is clear that currently agricultural policy makers in Ukraine confront with the underutilization of its agricultural potential and not overproduction. Thus, they directly support the gross production, in particular meat products. Although even in the short run it is questionable whether this production-oriented support without serious institutional changes results in a larger domestic production of meat and other agricultural products, in the medium term it will certainly lead to unfortunate side effects and unlikely to reduce the gap between agricultural and non-agricultural wages. Learning from the past experience of the farm support in Ukraine, we know that despite the growth of budget transfers from UAH 2.6 bill in 1996 to UAH 4.3 bill in 2003 and nominal agricultural output from UAH 27 bill to UAH 65 bill during the same period, the relative wages in agriculture compared to those in industrial sector fell from 0.63 in 1996 to 0.37 in 2003 (NBU, 2005 and OECD and WORLD BANK, 2004). Hence, production support, sugar quota and border protection are not only unsuited to achieve the sustainable improvements in standards of living for rural communities, they will also reduce the competitiveness of Ukrainian farms, addict the small group of beneficiaries to the subsidies, and discourage the EU to believe in seriousness of Ukraine's efforts to join the Union (see also DEMYANENKO and KUHN, 2004).

If Ukraine is to have a chance to join the EU, it must demonstrate desire and ability to adopt its policies, including agricultural, to EU standards. EU agricultural policy is a 'moving target' but the direction of this movement is very clear. Ukraine must anticipate this movement and embark now on a 'convergence course'. Only with more market oriented and attuned to

rural development, environment, food safety and quality agricultural policy, the policy makers may stimulate agricultural development, ensure fair standards of living for rural communities in Ukraine and keep prepared to join the EU.

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Appendix 1

There are two main ways in which the SFP as applied can depart from the original concept. First, to avoid 'desertification' of entire agricultural regions, member states can opt for **partial decoupling**. For example, France and Spain will be able to keep a link with production for up to 25% of the portion of the SFP relating to cereals, oilseeds and protein crops. Alternatively, mostly for Italy, 40% of the SFP payable could remain coupled, in respect of the supplementary durum wheat aid. For sheep and goat premia it has been allowed a 50% coupling. In the cattle sector, member states were allowed to have three options (Austria, Belgium, France, Portugal, and Spain): i) up to 100% coupling for the suckle cow premium and 40% for the slaughter premium; ii) 100% coupling for the slaughter premium; iii) up to 75% of the special male premium. Member states may make additional payments (so called "national envelopes") at national or regional level, "for the purposes of encouraging specific types of farming which are important for protection or enhancement of the environment and of improving the quality and marketing of agricultural products" (AGRA EUROPE, 2003). These payments can total up to 10% of a country's national aid ceiling. Since this is another form of decoupling, the money available for SFP would be reduced accordingly.

Member states may choose between **regional and farm-specific SFP models**. Under the farm model, each farmer receives similar amount of SFP as he received in the base period 2000-2002. So, this approach allows the differences in farm support among farms within the same region. Under the regionalized model, all money that would have been paid in a particular region (or country) is pooled, and then paid on a flat rate regional level with some adjustments for different types of land (arable land, pastures, etc.). This scheme equalizes the SPF among farms within the region. Most countries have opted for the farm-specific model, and only Germany and England have decided to implement the regional model (see details in BMVEL, 2005).

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